

DATE: January 26, 2011
TO: House Committee on Transportation
FROM: William E. Hamilton
RE: Transportation Funding: Revenue Sources and Distribution

Introduction

Michigan residents rely on a safe efficient transportation network for many reasons: to commute to work and school, for entertainment and social connections, to access medical services.

Transportation is also a critical part of the state economy. Transportation and warehousing, as a stand-alone segment of the economy, represents \$10 billion of Michigan's \$382 billion Gross Domestic Product, and accounts for 90,300 direct jobs out of total Michigan private employment of 3.2 million.¹ Transportation is also necessary for the success of other parts of the state economy.

The state of Michigan supports key elements of this transportation system through the annual state transportation budget. That budget provides funding for the construction and preservation of the state trunkline highway system; road and street programs of local road agencies (county road commissions, cities, and villages); capital and operating assistance to local public transit agencies; and airport capital improvement programs.

State Transportation Revenue and Distribution

Appropriations in the FY 2010-11 transportation budget total \$3.2 billion. Approximately two-thirds of the appropriated revenue comes from state restricted funds, and approximately one-third from federal-aid. The budget also includes the appropriation of a relatively small amount of local revenue representing the local government share of certain highway construction projects, transit capital projects or airport improvement projects. There is no state General Fund support in the transportation budget.²

Note: There are also some public funds used for transportation programs that are not appropriated in the state budget, including toll revenue from the Mackinac Bridge and the International Bridge, certain federal transit funds received directly by urban transit agencies, county or township road millages, dedicated millages or city general fund contributions to local transit agencies. However, most of these other revenues are dedicated to local or restricted programs, not statewide transportation needs. And these local sources of transportation revenue are relatively minor in relation to state transportation appropriations.

¹ Gross Domestic Product figure from Bureau of Economic Analysis data for 2008; employment data from Michigan Labor Market Information, Michigan Department of Labor and Economic Growth, September 2010.

² The FY 2010-11 budget bill, HB 5889, was enacted as PA 192 of 2010. The budget was developed from revenue estimates made in January 2010. The state transportation budget has ranged from \$3.0 billion to \$3.4 billion during the last ten years with the relative contributions of state restricted and federal revenue approximately two-thirds and one-third, respectively, over that period.

The balance of this paper will focus on primarily surface transportation programs, i.e. road and street programs, and public transportation programs. Those programs are governed by Public Act 51 of 1951. State aeronautics programs, governed by the State Aeronautics Code of 1945, will be discussed in a separate paper.

State-Restricted Revenues

Approximately \$2 billion in appropriated transportation revenue comes from state resources – primarily motor fuel taxes and vehicle registration taxes, in approximately equal measure.

These constitutionally restricted funds are first credited to the Michigan Transportation Fund (MTF) and then distributed to the following primary recipients in accordance with the provisions of Public Act 51 of 1951 (Act 51):

- > To the Comprehensive Transportation Fund (CTF) for public transportation programs, including capital and operating assistance to 79 local public transit systems
- > To the State Trunkline Fund (STF), for construction and preservation of the state trunkline system, and administration of the Michigan Department of Transportation
- > To 83 county road commissions to maintain county road systems
- > To 533 cities and villages to maintain city and village street systems

Act 51 also earmarks MTF revenue for certain targeted transportation funds and categorical programs: the Transportation Economic Development Fund (TEDF), the rail grade crossing account, and the Local Bridge Fund. **Approximately 65% of the MTF distribution is made to local road agencies or to local agency programs, including public transit programs.**

Although Act 51 act has been amended a number of times since 1951, the basic MTF distribution formula framework remains unchanged.³

Federal-Aid Revenue

In addition to state restricted revenue, the state transportation budget appropriates approximately \$1 billion in federal revenue available to the state through the multi-year federal aid authorization program, *Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU)*.⁴ SAFETEA-LU apportions funds to states through various categorical programs.

Because a significant number of federal-aid eligible roads and streets in Michigan are under the authority of local road agencies (county road commissions, cities, villages), Act 51 mandates that 25% of most federal aid program funds be set aside for projects under local jurisdiction.⁵

³ The current formula distribution of 39.1%, 39.1% and 21.8% of the net MTF balance to the STF, county road commissions, and cities and villages, respectively, is unchanged since 1982.

⁴ SAFETEA-LU authorized the federal surface transportation programs for highways, highway safety, and transit for the five-year period 2005-2009. SAFETEA-LU expired on September 30, 2009 and has had several short-term extensions.

⁵ The share of federal-aid eligible roads under local road agency jurisdiction is much higher in Michigan than most other states.

Considering the allocation of MTF revenue to local road agencies, local road agency access to categorical programs, the allocation of federal aid to local road agencies, and state and federal aid to public transit agencies and state airports, approximately 50% of the state transportation budget is distributed to local agencies and local programs.

Revenue Issues

Short-term Revenue Issues

State generated MTF revenue peaked in FY 2003-04 at **\$2.064 billion** and has declined each year since, primarily due to long-term declines in fuel taxes (less driving and more fuel efficient cars) and, more recently, reductions in registration taxes (people may be trading down to less expensive vehicles). The MTF revenue estimate for FY 2010-11 is **\$1.807 billion** – a reduction of \$257 million from FY 2003-04.

Reductions in MTF revenue result in reduced amounts credited to the STF, to local road agencies, and to public transportation programs.

While there has *not* been a decline in the amount federal aid available to the state, there has been recent concern about the state's ability to provide the required non-federal match – most commonly 20% of project cost. An anticipated \$84 million shortfall in state matching funds for FY 2010-11 would have caused the loss of \$475 million in federal aid.

Potential problems matching federal aid in both FY 2009-10 and FY 2010-11 were resolved. The department proposed, and the Legislature accepted, a plan to use a patchwork of one-time and short-term fixes to provide the match in both fiscal years. Some actions – such as \$40 million in short term borrowing – will make the matching problem worse in subsequent years.

If additional state matching funds are not identified, the state trunkline program may lose approximately \$500 million annually in federal aid starting in FY 2011-12. As a point of reference, the federal stimulus program provided approximately \$900 million in transportation funding to the state over two years.⁶

Is Money the Performance Measure?

While there is obvious concern about the long-term decline in the primary state source of dedicated transportation revenue (fuel taxes and registration taxes), and the immediate problem of matching federal revenue, the real question is whether state and federal revenues are sufficient to achieve statewide transportation goals. This brings us to more basic questions:

What are the state's transportation goals and priorities?

Are there measures for evaluating the efficiency and effectiveness of state transportation expenditures in meeting those goals and priorities?

⁶ The problem in providing sufficient matching funds for federal aid programs, and the potential loss of federal aid, has been focused exclusively the state trunkline program. It is not clear to what extent local road agencies will also have trouble providing matching funds for local federal aid programs.

MDOT Performance Measure – System Preservation

In 1997, the Michigan Department of Transportation adopted pavement and bridge condition performance goals and measures. The short-hand description of the pavement goal is that 90% of state trunkline pavement be in "good" condition by 2007. The department's classification of pavement as "good" or "poor" is based on a remaining service life model. The department established similar goals for state trunkline bridges.

The department uses an asset management process to identify which treatments to use at the optimal time to best preserve pavement. For example, the department may use capital preventive maintenance treatments to extend pavement life rather than waiting until pavements require more extensive and expensive reconstruction. The department's asset management process helps guide investments in order to preserve pavement in good condition and to prevent pavement from sliding into poor condition which is more expensive to fix.

The department met its pavement performance goal in 2007. However, based on its pavement performance models, the department will not be able to sustain pavement condition at current levels of investment. The department anticipates that pavement condition will start to deteriorate faster than it can keep up with preservation.

The department met the pavement performance goal in part by "front-loading" the reconstruction program through bonding. However, debt service payments reduce the amount of revenue available for the highway program in later years. The department estimates that over the next five years, the difference between estimated revenue and the revenue needed to maintain the state trunkline highway system at the 90% "good" condition will be approximately \$2.4 billion, i.e. a shortfall of approximately of \$470 million per year. Failure to make the investment in preserving the state trunkline infrastructure will result in a deterioration of pavement condition and higher future costs for reconstruction. The department has indicated that it also needs an additional \$110 million per year to maintain state trunkline bridges at optimal performance levels.

The department uses a graph to illustrate current and projected state trunkline pavement condition. The graph is used to illustrate the need for additional transportation revenue; it's often used as a proxy for the entire state highway network. However, the graph, and the transportation system it illustrates, represents the state trunkline system only – 8% of the total system.

This brings us back to the issue of transportation funding. The department indicates that it needs an additional \$470 million per year just to keep from falling behind in preserving its existing highway infrastructure. Under the current Act 51 distribution formula, the STF receives only 35% of net MTF revenue – 65% is apportioned to local road agencies and public transportation programs. The Legislature would have to increase transportation taxes by \$1.34 billion to generate the \$470 million needed for state trunkline programs. **The \$1.34 billion increase would equate to a 30 cent per gallon increase in the gasoline tax – the current tax is 19 cents per gallon – bringing the total tax to 49 cents per gallon.**

State Transportation Goals – System Improvements

The above discussion of transportation funding issues relates only to preservation needs of current state trunkline infrastructure. It does not consider funding for other highway system goals, such as improved safety, or capacity improvement. Capacity improvement needs are somewhat harder to quantify. However, there are several major projects which the department would pursue if there were sufficient money: widening of I-75 in Oakland County, reconstruction of I-94 in Detroit, reconstruction of US-23 in Washtenaw County, completion of US-127 between St Johns and Ithaca. The I-75 and I-94 projects are estimated to cost approximately \$1 billion each.

Any attempt to raise state transportation taxes to target these capacity projects would be thwarted by the current Act 51 formula; of each additional \$1 million raised in state transportation taxes, \$650,000 is distributed to the local road agencies and public transportation programs with only \$350,000 reaching the STF.

Problems in Establishing and Implementing Statewide Goals

The problem in establishing *statewide* transportation goals, directing state resources towards achieving those goals, and measuring performance in relation to those goals, is the fragmentary nature of the state transportation system and the current formula-driven method of distributing revenue.

There is not a single state transportation system; there are in fact 617 separate road jurisdictions in the state – 83 county road commissions, 533 cities and villages, and the Michigan Department of Transportation – not to mention 79 local public transit systems.

As described above, state transportation revenue is distributed or allocated to road agencies by statutory formula, or allocated to statutory categorical programs (TEDF, rail grade crossings, Local Bridge Program). In many cases funds allocated to a categorical program are further suballocated by population or jurisdiction.

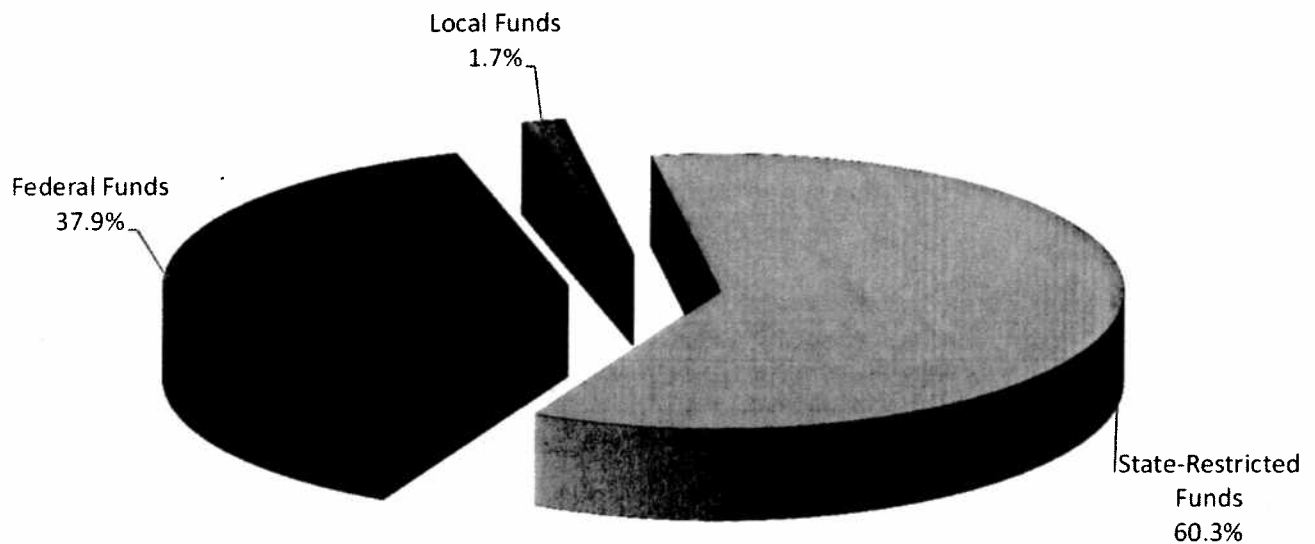
This fragmentation of the state transportation network, and the related formula-driven distribution of funds, may promote inefficiencies. Furthermore, the current formula-driven distribution of transportation funds does not appear to support *statewide* transportation goals.

Transportation Budget - FY 2010-11

As Enacted (with vetoes)
Summary by Source of Funds

State-Restricted Funds	\$1,950,974,400	60.3%
Federal Funds	1,227,470,600	37.9%
Local Funds	56,496,000	1.7%
Adjusted Gross Appropriation	\$3,234,941,000	100.0%

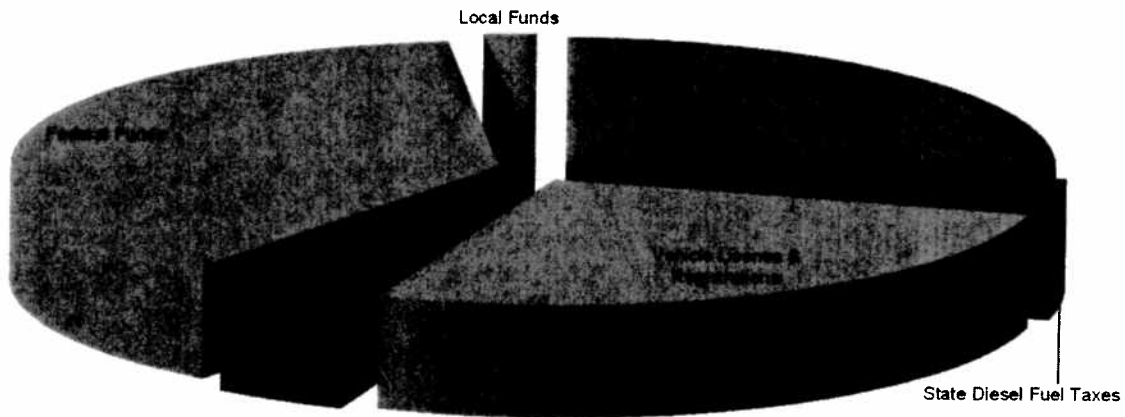
Transportation Funding FY 2010-11



Transportation Budget - FY 2010-11

Sources of Transportation Revenue

		% of Total Rev.
State \$.19/gal Gasoline Tax	\$826,000,000	
State Diesel Fuel Taxes	115,000,000	
Vehicle License & Registrations	864,500,000	
Other	145,474,400	
Subtotal State Revenue	\$1,950,974,400	60.31%
Federal Funds	1,227,470,600	37.94%
Local Funds	56,496,000	1.75%
Total Appropriated Funds	\$3,234,941,000	100.00%



Transportation Budget - FY 2010-11

Sources of Transportation Revenue

Based on Treasury Estimate (5/26/10)

			% of State Rev.	% of Total Rev.
State \$.19/gal Gasoline Tax	826,000,000	(1)		
Less Recreation Improvement Fund	(16,352,300)	(2)		
Gasoline Tax Subtotal	809,647,700	MTF	41.50%	25.03%
State Diesel Fuel Taxes	115,000,000	MTF	5.89%	3.55%
LP Gas Tax	400,000	MTF	0.02%	0.01%
Vehicle License & Registrations	864,500,000	MTF	44.31%	26.72%
Interest/Other	1,031,000	MTF	0.05%	0.03%
MTF Subtotal	1,790,578,700	MTF	91.78%	55.35%
Permits, Interest, Other Misc. Rev.	38,180,000	STF	1.96%	1.18%
IRS Bond Rebate	7,523,400	STF	0.39%	0.23%
STF Subtotal	45,703,400	STF		
BWB - Tolls and Rentals	21,282,000	BWBF	1.09%	0.66%
BWB - Interest	63,000	BWBF	0.00%	0.00%
BWBF Subtotal	21,345,000	BWBF		
Auto-Related Sales Tax	80,000,000	CTF	4.10%	2.47%
Other Fees/Misc	336,000	CTF	0.02%	0.01%
Interest	188,000	CTF	0.01%	0.01%
		CTF	0.00%	0.00%
CTF Subtotal	80,524,000	CTF		
State Aviation Fuel Tax	5,500,000	SAF	0.28%	0.17%
Airport Parking Tax	6,000,000	SAF	0.31%	0.19%
Interest and other Misc. Rev.	1,041,000	SAF	0.05%	0.03%
SAF Subtotal	12,541,000	SAF		
Total State Revenues	1,950,692,100			
Vetoed	(140,100)		-0.01%	
Reconciling Difference	422,400		0.02%	
Appropriated State Revenues	1,950,974,400		100.00%	60.31%
Federal Funds	1,227,470,600			37.94%
Local Funds	56,496,000			1.75%
Total Appropriated	\$3,234,941,000			100.00%

Notes

- Each 1 cent of the gasoline excise tax will generate \$43.5 million in revenue in FY 2010-11.
- 2% of gasoline excise taxes are appropriated to the Recreation Improvement Fund.

Key to Fund Abbreviations

MTF = Michigan Transportation Fund

STF = State Trunkline Fund

BWBF = Blue Water Bridge Fund

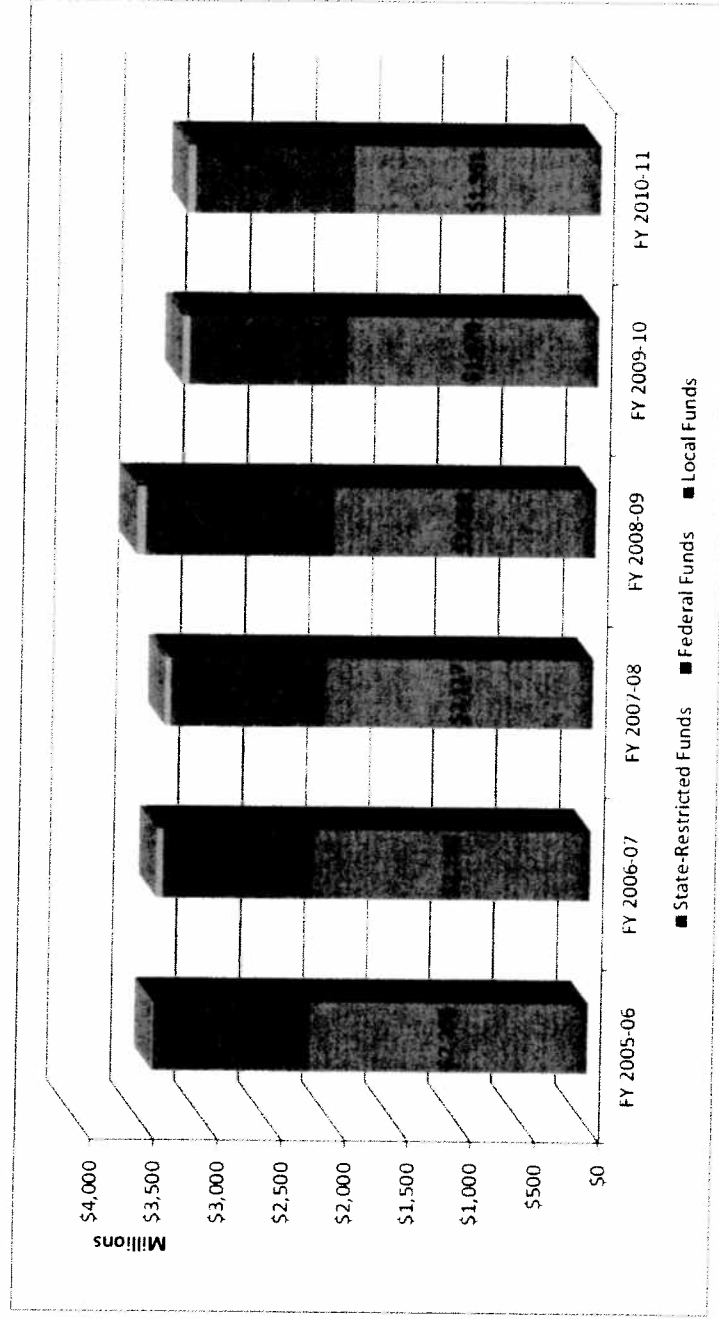
CTF = Comprehensive Transportation Fund

SAF = State Aeronautics Fund

Transportation Budget

FY 2005-06 through 2010-11

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11
State-Restricted Funds	\$2,208,159,900	\$2,192,012,700	\$2,116,605,000	\$2,068,009,200	\$1,978,578,800	\$1,950,974,400
Federal Funds	1,210,650,300	1,168,679,700	1,200,740,600	1,460,995,800	1,230,744,500	1,227,470,600
Local Funds	6,100,000	47,500,000	42,850,000	71,624,200	56,453,400	56,496,000
Adjusted Gross Appropriation	\$3,424,910,200	\$3,408,192,400	\$3,360,195,600	\$3,600,629,200	\$3,265,776,700	\$3,234,941,000



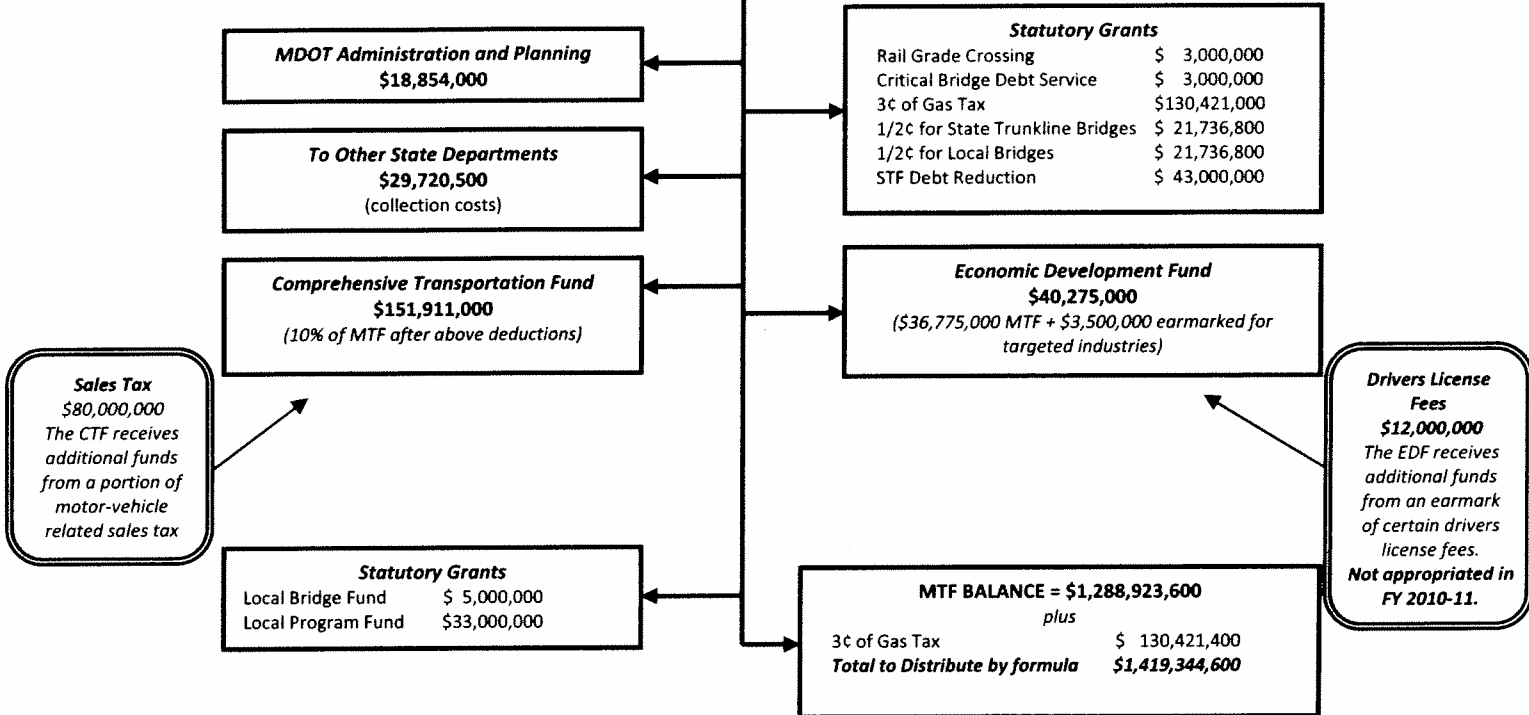
(Excluding ARRA)

**FY 2010-11 ESTIMATE OF TRANSPORTATION TAX REVENUES AND
DISTRIBUTIONS PER ACT 51**

May 2010 ORTA Estimate

MICHIGAN TRANSPORTATION FUND (MTF)

MTF Revenue = **\$1,806,931,000**
Less \$ 16,352,300 to DNR Recreation Improvement Fund
Net MTF Revenue = **\$1,790,578,700**



COUNTY ROAD COMMISSIONS

Total = **\$576,149,700**
39.1 % of MTF Balance \$503,969,100
39.1% of 3¢ Gas Tax \$ 50,994,600
(Plus \$21,186,000 from the Local Program Fund)

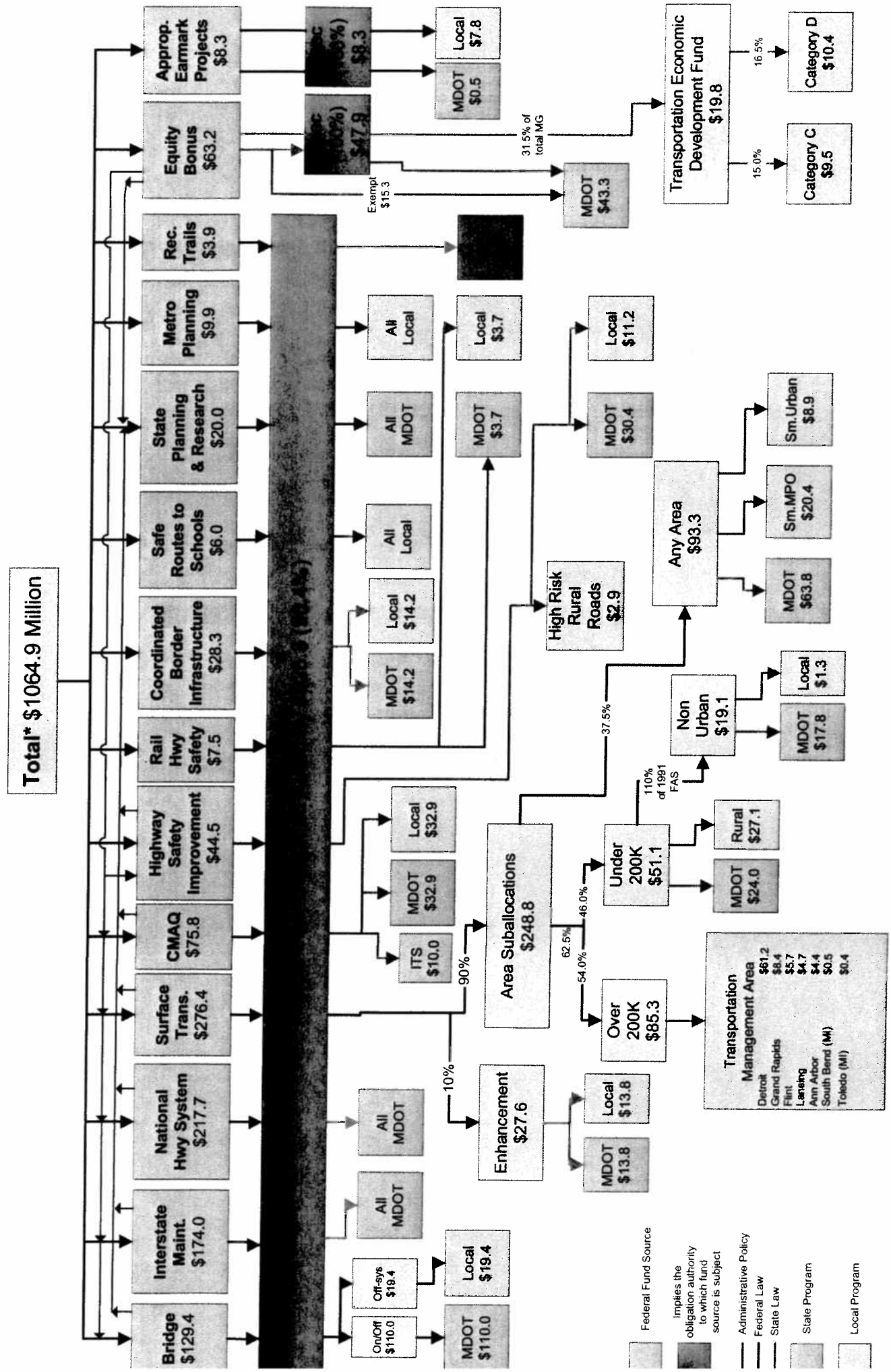
CITIES AND VILLAGES

Total = **\$321,231,100**
21.8% of MTF Balance \$280,985,300
21.8% of 3¢ Gas Tax \$ 28,431,800
(Plus \$11,814,000 from the Local Program Fund)

STATE TRUNKLINE FUND

Total = **\$619,700,500**
39.1 % of MTF Balance \$503,969,100
39.1% of 3¢ Gas Tax \$ 50,994,600
Plus \$21,736,800 from ½ cent of gas tax,
and \$43,000,000 for STF debt service

FEDERAL AID TO HIGHWAYS PROGRAM - MICHIGAN, FY 2010



State law requires that the sum of local federal allocations be 25% of Total funds, less CMAQ, Enhancement, Bridge, and Demo (& mid-year allocations).

Transportation Budget - FY 2010-11

As Enacted

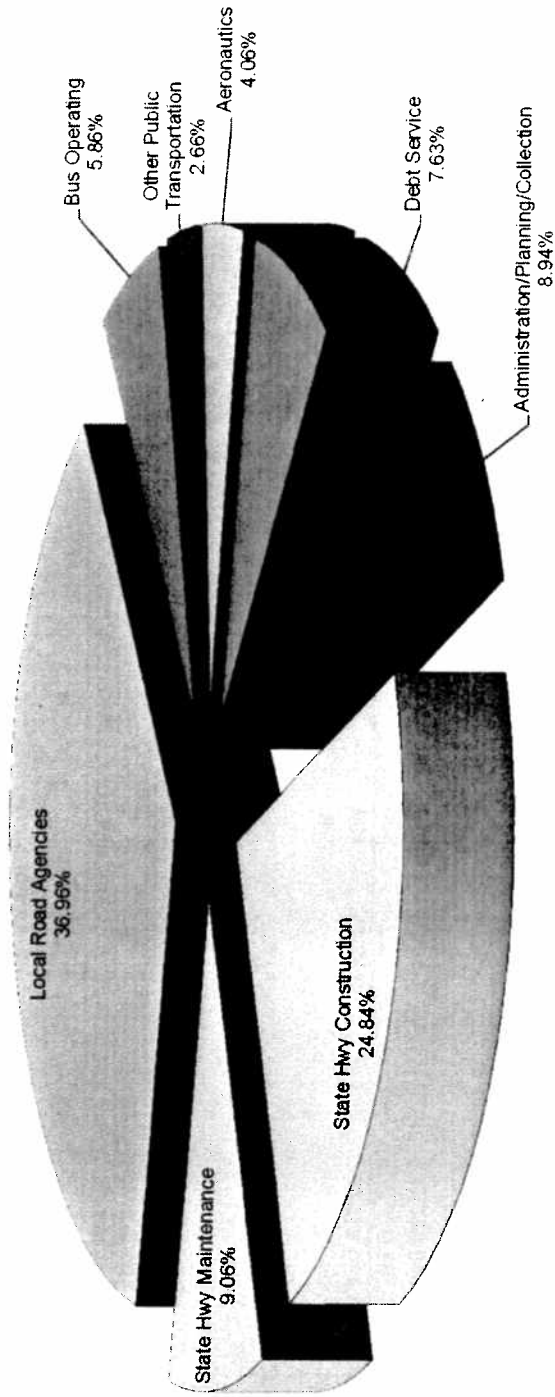
Summary of Appropriation by Program

Program	Total	Percent
Debt Service	\$246,813,000	7.63%
Administration/Planning/Collection	289,201,000	8.94%
State Hwy Construction	803,438,900	24.84%
State Hwy Maintenance	293,149,900	9.06%
Local Road Agencies	1,195,520,100	36.96%
Bus Operating	189,411,900	5.86%
Other Public Transportation	86,174,600	2.66%
Aeronautics	131,231,600	4.06%
Total	<u>\$3,234,941,000</u>	100.00%

This table shows the breakdown of FY 2010-11 transportation appropriations by major program.

Transportation Budget - FY 2010-11

As enacted
Summary of Appropriation by Program



Transportation Budget - FY 2010-11

As enacted

Summary of Appropriation by Program

	Total	Highway Programs	Public Transportation	Aeronautics
State	1,649,866,500	1,573,722,600	63,464,500	12,679,400
Local	1,585,074,500	1,209,522,800	252,305,300	123,246,400
Total	\$3,234,941,000	\$2,783,245,400	\$315,769,800	\$135,925,800
		86.04%	9.76%	4.20%

This table shows the breakdown of FY 2010-11 transportation appropriations by major programs and by state/local distribution.

In this table "State" refers to programs under control of MDOT for state transportation purposes, and "Local" refers to programs which involve the transfer of funds to local units of government.

Local units receiving highway program funds include county road commissions, and cities and villages (local road agencies).

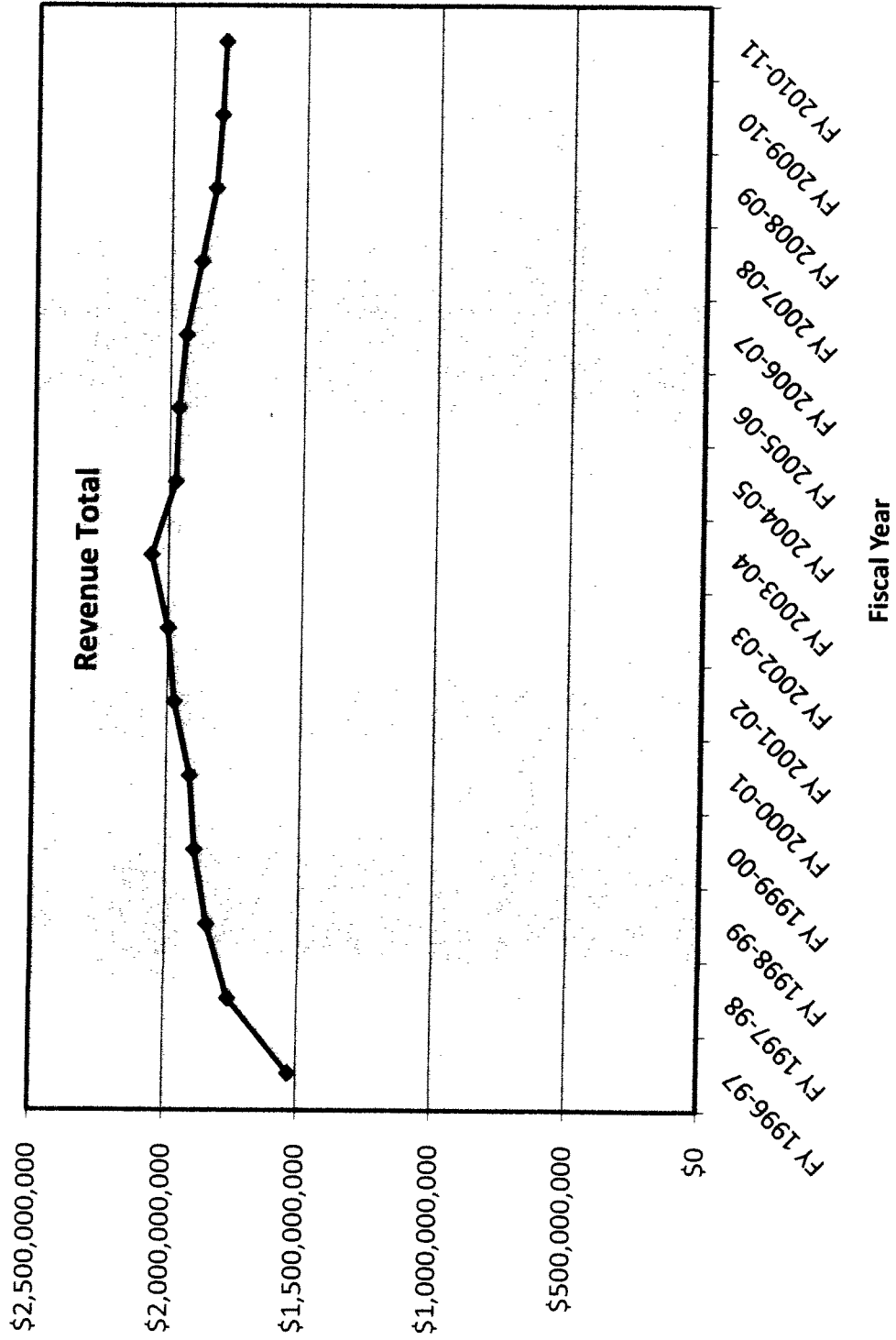
Local units receiving public transportation funds include public transit agencies for local bus operating assistance.

In some cases the classification of appropriations for this table as "state" or "local" is the judgment of the HFA analyst.

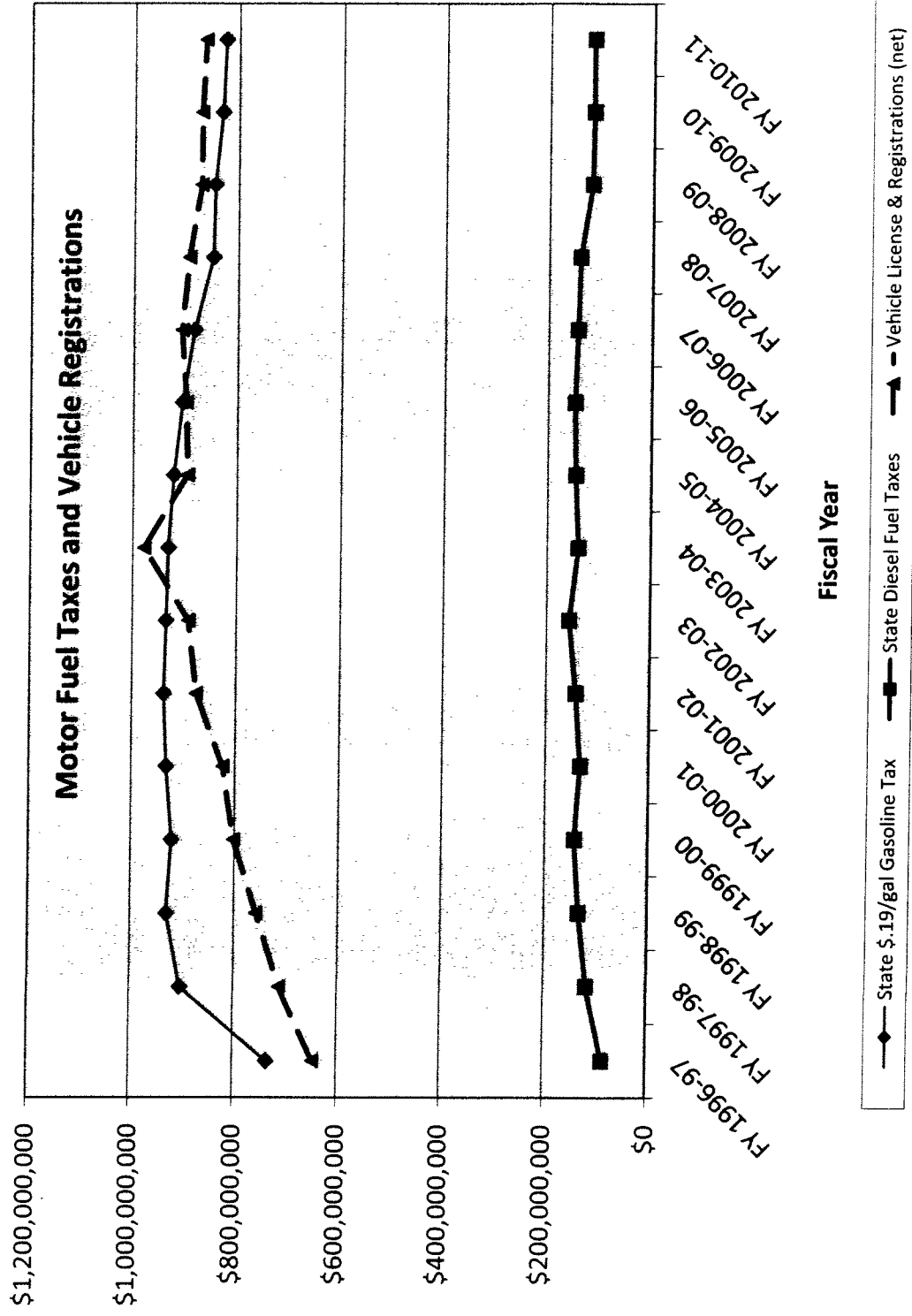
William E. Hamilton
December 3, 2010



MTF Revenue History



MTF Revenue History - Detail



Preserving the Highway System How Long Will the Pavement Last?

Historic and Projected RSL Pavement Condition
Current Strategy vs Match All Federal Aid Strategy

